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Certified Public Accountants

January 14, 2014

To the Honorable Mayor, the Common Council and Honorable Comptroller of
the City of Buffalo, New York:

In planning and performing our audit of the basic financial statements of the City of Buffalo, New York (the "City") as of and for the year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the City's internal control over financial reporting ("internal control") as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, significant deficiencies or material weaknesses may exist that have not been identified. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency presented in Exhibit I as item 2013-1 to be a significant deficiency in internal control.

In addition, during our audit we identified certain matters involving the internal control and other operational matters that are presented for your consideration. This letter does not affect our report dated November 26, 2013 on the financial statements of the City. We will review the status of these comments during our next engagement. Our comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the internal control or result in other operating efficiencies. We will be please to discuss these comments in further detail at your convenience, perform any additional study of these matters, or assist you in implementing the recommendations. Our comments are summarized in Exhibit II.

We also summarized new reporting requirements in Appendix A. These should be evaluated to determine the extent the City will be impacted in the future years.

The City's response to the significant deficiency relating to the Solid Waste and Recycling Fund deficit presented in Exhibit I as item 2013-1 has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

The purpose of this communication, which is an integral part of our audit, is to describe for management and those charged with governance, the scope of our testing of internal control and the results of that testing. Accordingly, this communication is not intended to be and should not be used for any other purpose.

Drescher & Malecki LLP

January 14, 2014

We consider the deficiency presented below to be a significant deficiency in internal control.

Finding 2013-1—Solid Waste and Recycling Fund Deficit

Criteria – Program revenues within a business-type activity should be adequate to meet the demands of providing the services for which the fund is responsible.

Condition – Annual operating deficits of the Solid Waste and Recycling Fund over the last five years have caused a fiscal strain to the City's General Fund. The City's General Fund has provided significant interfund advances to provide for sufficient cash for current Solid Waste and Recycling Fund operations. At June 30, 2013, the General Fund has advanced $16,060,342 to the Solid Waste and Recycling Fund. The Solid Waste and Recycling Fund's ability to repay this advance is questionable.

Over the past five years, the Solid Waste and Recycling Fund has reported operating losses. The operating expenses, on average, have increased about 2.69% per year while operating revenues have lagged behind. Operating revenues over the same period, on average, have increased by less than 0.27% per year.

Effect – The Solid Waste and Recycling Fund is not adequately supporting its program expenses with charges for services.

Cause – The Solid Waste and Recycling Fund's charges for services are not adequate to support the current level of spending within the fund. As a result, the General Fund is providing the Solid Waste and Recycling Fund with both interfund loans and annual operating subsidies that are reducing the gap between expenses and revenues. For the year ended June 30, 2013, the Solid Waste and Recycling Fund's operating loss was $6,209,117, which was partially offset by approximately $3 million of operating subsidies from the City's General Fund.

Recommendation – Consistent with Section 216.58 of the City's Charter, we recommend that the City establish appropriate Solid Waste and Recycling Fund basic residential and commercial rates that will generate sufficient revenue to support program expenses within the fund.

The City should develop a formal plan to have the General Fund recover the amounts advanced to the Solid Waste and Recycling Fund. The plan would require that not only should the basic residential and commercial rates generate sufficient revenue to support program expenses within the fund, the rates should also repay the General Fund for the prior advances with interest. If the City ascertains that such a funding plan is not feasible, the City should determine their responsibility of having the General Fund taxpayers increase their subsidy to the Solid Waste and Recycling Fund.

Management's Response – Management is continuing the process of developing a formal deficit reduction plan for the Solid Waste and Recycling Fund, which will include the evaluation of the need for rate increases.

Additionally, we provide the following observations and recommendations for your consideration:

Purchase Orders

While performing testing of expenditures, it was noted that items have purchase orders that are dated subsequent to the dates of the invoices they related to. Purchase orders must be reviewed and approved by the Purchase or Audit Divisions prior to initiating the purchase from the vendor/service provider. Goods and services should not be ordered until a purchase requisition is created to ensure that the form is received, reviewed and approved by the Purchase or Audit Departments prior to initiating the purchase from the vendor/service provider.

We recommend that the City adhere to its policy and ensure there is approval of a purchase order before the actual purchase is made.

Segregation of Duties

While performing revenue control testing within the City Clerk's Office, it was noted that there is a lack of segregation of duties surrounding cash collections. Employees within the Clerk's office do not use separate cash drawers. Additionally, all employees in the office use the same MUNIS user account to process payments. As such, it is difficult to decipher which employee has collected and recorded the payment and cash being received.

We recommend that the City use multiple cash drawers and unique MUNIS account access to process payments. Employees should not share a cash drawer; rather, each employee responsible for processing payments should be assigned a cash drawer in order to eliminate the opportunity for fraud. Alternatively, we recommend that the City consider the elimination of the receipt of cash in the City Clerk's Office and centralize this process in the Division of Treasury.

Data Backup

While we have acknowledged that the City's Management Information Systems ("MIS") department performs regular backups of data they have access to, we noted that there are some separate departments within the City that do not perform regular backups of their own data. Many of these departments have their own information infrastructure and personal computers, which are not regulated by MIS. This data may provide support for the information reported within the City's financial statements, and the lack of backups makes the information susceptible to loss.

We recommend that each department develop policies in order to mandate that regular backups are performed. This will ensure that in the event of loss, relevant data will be recoverable.

Delinquent Taxes Listing

While performing testing of delinquent taxes receivable, it was noted that the City was unable to generate a detailed report of delinquent taxes receivable as of June 30, 2013, by property, that agreed to the general ledger. The reporting system which maintains the delinquent taxes receivable detail cannot easily run detail for previous dates. Essentially, this detail report should be run on June 30th to tie to the general ledger.

We recommend that the City implement a process to ensure a detailed report of delinquent taxes receivable, by property, is able to be generated. This process should also ensure the report detail can be reviewed for the account balance of delinquent taxes receivable at any point in time.

Terminated Employee Notification

As noted in prior year, the City does not have a formal policy or process in place regarding the steps necessary to process an employee's termination. There is a risk that terminated employees might retain access to the City's facilities as well the City's computer network and applications.

We recommend that the City's Human Resources Department devise, implement and enforce policies and procedures whereby immediately upon an employee's termination, the appropriate departments (e.g., Building Facilities and MIS) are notified and take appropriate steps to ensure access to the City's facilities as well the City's computer network and applications are accordingly restricted.

Capital Asset Policy

As noted in prior years, the City does not currently have a complete and formalized capital asset policy. There are no written procedures to ensure that disposals of capital assets are reported to the accounting department as they occur, nor are there any policies or procedures regarding construction-in-process. Additionally, with the exception of vehicle purchases, there are no guidelines which require City departments to notify the accounting department when a capital asset is acquired. It is currently the responsibility of the accounting department to perform a search of expenditures made throughout the year in order to identify those that qualify as a capital asset. Lastly, we noted that there has not been a physical inventory of capital assets performed in several years.

We recommend that the City create and adopt a complete, formal policy covering topics including the disposal of capital assets to ensure the reporting of capital asset disposals is accurate and appropriately approved. Similarly, departments should inform the accounting department in a timely manner when new assets are acquired. A standardized form could be developed to provide adequate accounting documentation and to provide evidence of adherence to the City's policy. We also recommend that the City add to their Capital Asset Guide procedures surrounding construction-in-progress and guidelines for items to capitalize and items to expense as repairs and maintenance. Lastly, we recommend that the City perform a physical inventory of their capital assets as soon as possible.

New Reporting Requirements

The Governmental Accounting Standards Board ("GASB") has adopted several new pronouncements, which may have a future impact upon the City:

GASB Statement No. 66—The City is required to implement GASB Statement No. 66, *Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62*, for the fiscal year ending June 30, 2014. The objective of this statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

GASB Statement No. 67—The City is required to implement GASB Statement No. 67, *Financial Reporting for Pension Plans-an amendment of GASB statement No. 25*, for the fiscal year ending June 30, 2014. This statement replaces the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* and Statement 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria. It builds upon the existing framework for financial reports of defined benefit pension plans, which includes a statement of fiduciary net position (the amount held in a trust for paying retirement benefits) and a statement of changes in fiduciary net position. Statement No. 67 enhances note disclosures and required supplementary information ("RSI") for both defined benefit and defined contribution pension plans. Statement No. 67 also requires the presentation of new information about annual money-weighted rates of return in the notes to the financial statements and in 10-year RSI schedules.

GASB Statement No. 68—The City is required to implement GASB Statement No. 68, *Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No.27*, for the fiscal year ending June 30, 2015. This statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and Statement No. 50, *Pension Disclosures,* as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. This statement requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. It also enhances accountability and transparency through revised and new note disclosures and RSI.

GASB Statement No. 69—The City is required to implement GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, for the fiscal year ending June 30, 2014. This statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations (mergers, acquisitions, and transfer operations). This statement provides specific accounting and financial reporting guidance for combinations in the governmental environment. The statement also improves the decision usefulness of financial reporting by requiring that disclosures be made by governments about combination arrangements in which they engage and disposals of government operations.

GASB Statement No. 70—The City is required to implement GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Guarantees*, for the fiscal year ending June 30, 2014. This statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. The requirement of this statement will enhance comparability of financial statements amount governments by requiring consistent reporting by those governments that extend nonexchange financial guarantees and by those governments that receive nonexchange financial guarantees.

GASB Statement No. 71—The City is required to implement GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date,* for the fiscal year ending June 30, 2015. The objective of this statement is to address an issue regarding application of the transition provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No.27*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability.